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The Manufacturers Hanover
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Weekly Commentary, Selected Financial Data, and Business Indicators

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More Good News On Inflation

Among the more favorable economic developments occurring during the early months of 1981 has been a marked reduction in the rate of inflation. This trend continued in May. The producer price index (PPI) for finished goods rose only 0.4 per cent last month, following an increase of 0.8 per cent in April and a sizable 1.3 per cent rise in March. At other stages of processing, the improvement was even more dramatic. Raw materials' prices declined by 0.5 per cent in May compared with April, in sharp contrast with the 1.5 per cent increase just one month before. At the intermediate level, producers' costs rose by 0.5 per cent, which was less than half the rate posted in April.

Food prices continue to exert a favorable impact on the rate of inflation. Raw foodstuffs and feedstuffs, which declined in five out of the last six months—fell by 1.1 per cent in May. This, in turn, lowered the cost of farm products at other stages of production, especially at the intermediate level, where materials for food manufacturing posted a 1.4 per cent drop. Finally, costs to retailers remained relatively unchanged as finished foods' prices rose a slight 0.2 per cent.

Another major factor dampening the rate of inflation last month was energy. Prices of refined petroleum products dropped 1.1 per cent in May month-over-month following a 1.7 per cent increase in April and a 7.4 per cent jump in March. Despite the strike by the United Mine Workers, coal prices fell 0.7 per cent during the month. What is more, the outlook for energy prices is for further moderation in the months ahead. The dramatic decline in domestic and global petroleum consumption, together with continuing high production assures further downward pressures on world crude oil prices.

Increased Defense Spending . . .

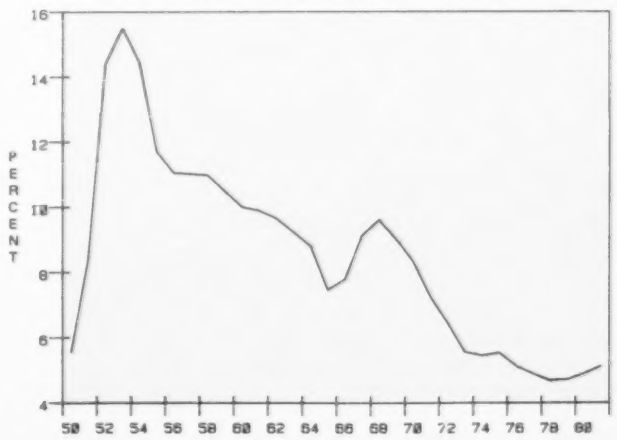
However, the improvement in inflation may be retarded by increased Federal government spending on national defense. The estimate by the Office of Management and Budget of average "real" growth in defense outlays of 10.5 per cent per year over the next five years has caused concern in some quarters, because every major defense buildup since World War II has been accompanied by rapidly accelerating inflation. The most frequent comparison is made with the military buildup associated with the Vietnam war in the 1960s, which touched off a price surge that lifted the average rate of inflation from less than 1.3 per cent per annum in the first half of the 1960s to close to six per cent annually at the end of the decade.

Government spending on defense tends to be more inflationary than private spending because the items that are eventually produced do not add to the supply of goods and services available for domestic consumption, even though workers have more buying power. However, although stepped-up real military spending may give a boost to inflation, it is not likely to impact prices as much as it did in the 1960s.

. . . May Not Be Too Inflationary

First, and of primary importance, the buildup is going to be spread over a longer period of time. According to OMB estimates, real defense spending is forecast to rise by about 50 per cent over the next five years. This compares with a similar-sized expansion of real defense outlays that took only three years in the 1960s. Second, the economy can

FEDERAL BUDGET OUTLAYS FOR NATIONAL DEFENSE AS A PERCENT OF GNP (CONSTANT 1972 DOLLARS)



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absorb this expansion much better than it could during the earlier period, since real defense expenditures now account for a much smaller share of the real GNP (see chart on previous page). Even if the President's proposals are enacted in their entirety, defense spending will represent less than seven per cent of the GNP when inflation is factored out — below the 7.5 per cent level that prevailed *prior* to the Vietnam buildup.

The claim on manpower and materials will also be less taxing this time because today's economy has much more room to expand without risk of developing severe bottlenecks, thus driving up wage and supply costs. Those shortages that do develop should be confined to such very specialized materials as strategic metals or certain types of skilled labor, such as electrical and nuclear engineers. Finally, capacity utilization in all manufacturing was 90 per cent immediately preceding the 1965-68 military buildup. Currently, it is barely above 80 per cent. The unemployment rate was 4.5 per cent in 1965; today it stands at 7.6 per cent.

The Economy Remains Stagnant

Utilization of both labor and machinery is likely to stay low for the next few months. The U.S. economy seems to be stagnating after the robust 8.4 per cent annual rate gain in the first quarter. Most of the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	6/3/81		
U.S. Gov'ts and Agencies Owned Outright & RPs	128.167	– .665	– 4.279
Loans to Depository Inst.	1.954	– .969	+ 1.495
Float	4.099	+ 1.728	+ .156
Total Reserve Bank Credit	143.710	– .280	+ 1.398
Treasury Deposits with Federal Reserve Banks	2.982	+ .152	– .904
Currency Outside Banks	122.375	– .259	+ 7.635
Member Bank Reserves:			
Required	39.855	+ .045	– 3.911
Excess (Deficiency)	.381	– .058	– .011
Total Reserves Held	40.236	– .013	– 3.922
Net Borrowed Reserves	1.286	– .889	+ 1.240
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.536	– .980	+19.824
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M-1A	361.1	– 3.5‡	– 1.2‡
M-1B	424.6	+ 6.8‡	+ 10.2‡
M-2 (April '81)	1,735.5	+ 12.8	+ 11.9
L (February '81)	2,421.5	+ 12.8	+ 10.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 6/12/81			
‡U.S. Treasury Bills	14.20%	13.45%	12.50%
* Federal Agencies	14.38	14.35	14.30
* Project Notes—Taxfree (46% Taxable Equivalent)	12.87	13.15	13.33
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	16.60	15.75	

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	17.25%	Jul.	17.10%
15- 29 days	17.25	Aug.	16.40
30- 59 days	17.00	Sep.	15.85
60- 89 days	16.00	Oct.	15.70
90-179 days	15.00	Nov.	15.20
180-239 days	14.50	Dec.	14.65
240-270 days	13.00		

‡Industrial Paper—Prime			
30- 89 days	17.25%	†Federal Funds Effective Rate	18.35%
90-120 days	16.00		

‡Discount basis. * Subject to availability. r Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'81	$ 2,854	$ 2,731	$ 2,572
Gross National Product (1972 Dollars)*	1st Q'81	$ 1,516	$ 1,486	$ 1,502
Percent Change, Annual Rate	1st Q'81	8.4%	3.8%	3.1%
Change in Consumer Prices (all urban consumers)*	Apr '81	4.8%	7.2%	10.8%
Change in Producer Prices*	May '81	4.8%	9.6%	6.0%
Civilian Employment (Thousands of Persons)†	May '81	99,235	98,976	97,116
Unemployment as % of Civilian Labor Force†	May '81	7.6%	7.3%	7.6%
Personal Income*	Apr '81	$ 2,351	$ 2,338	$ 2,102
Leading Indicators Composite Index (1967=100)†	Apr '81	138.3	137.8	126.2
Industrial Production Index (1967=100)†	Apr '81	152.8	152.2	148.3
Net Change in Consumer Installment Credit†	Apr '81	$ 2.33	$ 3.11	–$ 1.67
U.S. Merchandise Trade Balance†	Apr '81	–$ 2.47	$ 0.49	–$ 1.20
Plant and Equipment Expenditures*	3rd Q'81n	$322.88(a)	$317.29(a)	$296.23
Private Housing Starts (Thousands of Units)*	Apr '81	1,343	1,289	1,044
New Construction Expenditures*	Apr '81	$ 244.6	$ 251.5	$ 225.8
Total Business Inventories†	Mar '81	$ 471.8	$ 470.8	$ 443.0
Total Business Sales†	Mar '81	$ 345.9	$ 346.4	$ 310.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

upward momentum has evaporated, and a spreading weakness appears to have developed in many key sectors during the second quarter. For example, industrial production rose in April, but by only 0.4 per cent month-over-month. Retail sales gained 0.2 per cent in May – but this follows a 2.1 per cent setback in April, which was the largest monthly decline since March, 1975. Outstanding consumer installment credit expanded at a healthy pace in April, but most of the advance was attributed to auto rebates which were subsequently ended.

Housing and automobiles remain severely depressed. Housing starts have inched up slightly in the past two months, but they still are at their lowest level since the summer of 1980. Automobile sales ran at a 5.7 million unit annual rate in April and May – down from the 7.7 million unit rate posted in March while the rebates were in effect. Although these two sectors have been and will continue to be crucial determinants of the overall pace of economic activity, their relative importance has been increasingly overshadowed by the growth of the energy, defense, and high technology industries. This group in particular has offset the slump in autos and housing – at least until now. However, it would appear that the balance has tipped back toward autos and housing, for the overall economy seems to be declining.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (5/27/81)	120,051	+ 1,042	+25,425
New York City (5/27/81)	28,020	– 487	+ 5,708
Commercial Paper (5/27/81)	143,084	+ 520	+19,656

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/27/81)	175,448	+ 586	+17,541
New York City (5/27/81)	51,348	+ 393	+ 4,897

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/27/81)	434,005	+ 2,075	+40,342
New York City (5/27/81)	103,034	+ 1,075	+13,668

Financial Markets

	Friday 6/12/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	14.78%	– 1.79	+ 8.34
180-Day Bills†	14.68	– 1.32	+ 7.49
Longest Bills†	14.26	– .91	+ 6.59
Recent Issues:			
15⅝s 5/31/83	13.87	– 1.53	
13⅜s 3/31/85	13.77	+ .79	
14½s 5/15/91	13.30	– .51	
13⅞s 5/15/11	12.67	– 1.29	
Municipals:			
Bond Buyer–20 Bond Index* (6/11/81)	10.63%	+ .04	+ 3.10
Blue List Total ($ Million)	$1,080	+ $260	+ $ 37
30-Day Visible Supply ($ Million)	$2,005	– $162	– $ 599
Total	$3,085	+ $ 98	– $ 562
Corporates:			
Moody's Aa Composite (6/11/81)	14.39%	– .33	+ 3.07
Money Mgr.–30-Day Supply ($ Million)	$5,859	– $510	+ $3,192
Stocks:			
Dow-Jones Averages:			
Industrials	1,006.28	+ 12.49	+ 129.83
Transportation	426.34	+ .06	+ 148.61
Utilities	110.08	+ 4.38	– 3.69
65 Stocks	388.73	+ 4.90	+ 71.23
Standard and Poor's 500 Stocks	133.58	+ 1.48	+ 17.77
N.Y.S.E. Composite Index	77.60	+ .87	+ 11.47
N.Y.S.E. Avg. Daily Vol. for Week (000's)	52,038	– 2,002	+ 9,628

* 46% Taxable equivalent 19.69%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/12/81	Week Ago
Overnight	18.63%	19.38%
1 month	18.38	19.00
3 month	17.75	18.50
6 month	16.88	17.38
1 year	16.13	16.50
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.75%	14.75%
Long Term (7 to 15 yrs.)	14.75	14.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/12/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02553	39.17
Canada	.8302	1.2046
Denmark	.1326	7.5400
France	.1751	5.7100
Germany	.4169	2.3985
Italy	.0008368	1195.00
Japan	.004447	224.85
Mexico	.04114	24.31
Netherlands	.3748	2.6680
Switzerland	.4746	2.1070
U.K.	1.9495	.5130